

MILBERG'S MONOPOLY: RESTORING HONESTY AND COMPETITION TO THE PLAINTIFFS' BAR

JAMES P. McDONALD[†]

ABSTRACT

When the renowned plaintiffs' firm Milberg Weiss was indicted in 2006 for paying kickbacks to clients, most commentators saw the scandal as the product of five dishonest lawyers. This Note argues that the causes were more complex than the moral shortcomings of a few attorneys; rather, the kickbacks were but one symptom of a deeply flawed system for selecting lead counsel in securities class action lawsuits. Although the Private Securities Litigation Reform Act of 1995 attempted to curb abusive behavior by the plaintiffs' bar, its focus on reforming plaintiff behavior meant that attorneys were left relatively free to continue using whichever tactic served their financial ends. Using Milberg Weiss's behavior to guide analysis, this Note assesses the problems of lead-counsel selection. These problems trace to a common source: an imbalance of information between attorneys vying for appointment as lead counsel and the judge who must select one of these attorneys. To correct this problem, this Note proposes implementing screening and signaling procedures to determine the "most adequate counsel" who can provide quality representation for every member of a class.

Copyright © 2008 by James P. McDonald.

[†] Duke University School of Law, J.D. expected 2009; Bowdoin College, A.B. 2005.

I thank Professor Ogden N. Lewis for his wise oversight of this Note, as well as Joshua Haber, Kelly Taylor, Mom, and Dad for their thoughtful comments along the way. In the course of researching and writing this Note, I contacted a number of individuals for interviews, including William Lerach, who graciously shared his time and assistance. Some people I contacted chose to participate in these interviews, and some chose to participate only on the condition of anonymity. In the case of anonymous sources who permitted me to use their information, I have cited those sources as "Confidential Source" with no other identifying information to respect their requests for anonymity. Please accept my apologies for the absence of information but take my strongest assurances that all sources are quoted and represented accurately in the pursuit of the truth.

INTRODUCTION

This is the story of the lawyer, William Lerach, who took on Enron, won \$7 billion for his clients, and was headed for federal prison before the Enron case ended. It is also the story of his former law firm, Milberg Weiss, whose Enron-like collapse in 2006 for fraud and obstruction of justice transformed a legal powerhouse into a legal pariah. But, mostly, it is the story of how the class action system failed to protect American investors who lost billions of dollars to corporate fraud and malfeasance.

Until its 2006 indictment by federal prosecutors in California,¹ the law firm of Milberg Weiss dominated the securities class action plaintiffs' bar.² Led by two skilled plaintiffs' lawyers with reputations matching their paychecks, Melvyn Weiss (the firm's cofounder) and William Lerach (the firm's most prominent attorney), Milberg Weiss was one of the most prominent plaintiffs' firms in America from the early 1980s until 2006.³ The firm survived a bipartisan Congress determined to destroy it,⁴ new procedural laws aimed at curbing its influence,⁵ and constant criticism from American business interests and the academy.⁶ Milberg Weiss fancied itself the voice of the little guy, the defrauded investor, in a battle against large corporate

1. First Superseding Indictment at 24–78, 84–89, 94–96, 100–01, *United States v. Milberg Weiss Bershad & Schulman LLP*, CR 05-587(A)-DDP (C.D. Cal. filed May 18, 2006) (on file with the *Duke Law Journal*).

2. For an examination of the statistics on Milberg Weiss's dominance of the market, see *infra* notes 165–69 and accompanying text.

3. For information regarding Milberg Weiss's market share in the securities class actions market, see *infra* Parts I.A, II.B.

4. See Joseph Nocera, *The Lawyer Companies Love to Hate*, N.Y. TIMES, July 2, 2005, at C1 (“In 1995, Congress passed the Private Securities Litigation Reform Act, whose purpose, in part, was to put Mr. Lerach out of business.”).

5. See *id.* (describing the Private Securities Litigation Reform Act).

6. See Peter Elkind, *The King of Pain is Hurting*, FORTUNE, Sept. 4, 2000, at 190, 198 (“For Silicon Valley companies especially, a number of which Lerach sued repeatedly, dealing with Milberg became predictable—‘like paying a toll to cross the Bay Bridge,’ says San Francisco defense attorney Doug Schwab. They called it ‘getting Lerached.’”). For a discussion of academic criticism of Lerach's and Milberg Weiss's tactics, see *infra* Part II.B.

interests.⁷ In that battle, it claims to have won more than \$45 billion in settlements and judgments for its clients since 1965.⁸

But, as this Note details, some of the tactics that Milberg Weiss used to reach the top of the plaintiffs' bar were as fraudulent and unethical as any action taken at Enron, WorldCom, or Tyco.⁹ Between the mid-1970s and 2005, Milberg Weiss paid more than \$11.3 million in kickbacks to clients who agreed to serve as plaintiffs in class action lawsuits.¹⁰ Prompting its own clients to file the first lawsuit in a class action meant that the firm would control the litigation as lead counsel, a position that guaranteed it the highest percentage of legal fees awarded from a settlement or judgment.¹¹

Every law firm in the plaintiffs' bar aspires to appointment as lead counsel in a securities class action lawsuit, for the financial rewards can be astronomical.¹² Prior to 1995, lead-counsel status typically was awarded to the first plaintiff and lawyer to file a lawsuit, a rule that led many lawyers to file "strike suits," poorly researched private actions based on little more than a hunch that fraud had occurred.¹³ Although Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA)¹⁴ to put an end to strike suits

7. Carrie Johnson, *Guilty Plea to End Crusading Lawyer's Lucrative Run*, WASH. POST, Sept. 19, 2007, at A1 ("Having grown up in a working-class Pittsburgh home, Lerach regularly described himself as an advocate for 'the little guy.' Legal experts agree that his cases gave investors who lost money a new avenue to recover at least pennies on the dollar. His cases also infuriated his opponents in the corporate and political arena.").

8. Russell Kamerman, Note, *Securities Class Action Abuse: Protecting Small Plaintiffs' Big Money*, 29 CARDOZO L. REV. 853, 854 (2007).

9. For a discussion of these scandals, which involved some of America's most prominent corporations at the beginning of the twenty-first century, see generally Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

10. Second Superseding Indictment at 9–14, *United States v. Milberg Weiss Bershad & Schulman LLP*, CR 05-587(D)-JFW (C.D. Cal. filed Sept. 20, 2007) (on file with the *Duke Law Journal*); see also Peter Elkind, *The Law Firm of Hubris Hypocrisy and Greed*, FORTUNE, Nov. 13, 2006, at 155, 156 (discussing the illegal kickbacks).

11. Elkind, *supra* note 10, at 160–61.

12. See Kamerman, *supra* note 8, at 855 ("Representing a class in a securities class action is a coveted position among law firms because a large amount of money is often at stake and the firm's fee structure usually consists of a percentage of any settlement or judgment."); Elkind, *supra* note 10, at 164 (noting that one David Bershad made approximately \$161 million in approximately twenty-two years of practice at Milberg Weiss).

13. Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Action*, 104 YALE L.J. 2053, 2085–86 (1995).

14. Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

and other deceptive practices Milberg Weiss used to become lead counsel,¹⁵ the available data indicates that the PSLRA helped Milberg Weiss more than it hurt the firm.¹⁶ By 2006, Milberg Weiss and Lerach acted as lead counsel in approximately 60 percent of all securities class actions filed in the United States, and 80 percent of the securities class actions filed in California.¹⁷ Yet Milberg Weiss's story is more than one of market domination; it is a legal tragedy about the repeated breach of the fiduciary duty that lead plaintiffs and their lawyers owe to absent class members.¹⁸ It is a breach against which the class action system continues to have no adequate defense.

This Note criticizes the existing system of selecting lead counsel for inadequately preventing abusive attorney behavior and offers solutions to aid judges in more accurately selecting a lead counsel that meets the appropriate legal and moral standards. Exploring both the legal and illegal tactics Milberg Weiss used to garner lead-counsel status, this Note offers two contributions to securities law—one historical and one analytical. First, the Note presents a historical account of the Milberg Weiss fraud through the lens of the firm's most famous attorney, William Lerach. Compiling a number of sources and firsthand accounts, including Mr. Lerach's own words, this Note is the first academic narrative detailing the inner workings of the scandal in this manner. Second, this Note uses the facts of the Milberg Weiss scandal to elucidate why the PSLRA system for selecting lead counsel was poorly crafted and remains vulnerable to fraud. The drafters of the PSLRA neither identified nor corrected informational asymmetries that exist between plaintiffs' attorneys and judges. Because plaintiffs' attorneys continue to operate with vastly superior information about their clients, their own motivations, and the merits of a particular case, judges are unable to appraise the adequacy of the attorneys vying for lead counsel. Only by fostering or

15. Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 914–15.

16. See *infra* notes 165–75 and accompanying text.

17. Michael A. Drummond, *Lerach Strikes Back*, CAL. LAWYER, Sept. 4, 2002, at 23, 25, available at http://www.nera.com/MediaCoverage.asp?pr_ID=1500.

18. See, e.g., *In re Cendant Corp. Sec. Litig.*, 404 F.3d 173, 198 (3d Cir. 2005) (“The lead plaintiff is not the sole client in a PSLRA class action; instead, the lead plaintiff serves as a fiduciary for the entire class. A court must therefore retain oversight over lead plaintiff’s compensation decisions in order to ensure that the lead plaintiff has fulfilled its fiduciary duties.”).

forcing disclosure between these actors can the legal system realize the goal of adequate representation for all class members.

To tell the Milberg Weiss story and analyze the faults of the lead-counsel-selection system, this Note is divided into three Parts. Part I examines the old system of lead-counsel selection and how that system led to the PSLRA, the law intended to check the plaintiffs' bar. Part II details the Milberg Weiss system of lead-counsel selection, also known as the kickback scheme. The Part examines how the firm recruited plaintiffs, paid them to file lawsuits, and evaded detection by the courts. Part III analyzes the post-Milberg Weiss system, concludes that significant information asymmetries still exist to the detriment of class members, and suggests a new system of disclosure between attorneys and the courts to prevent the emergence of another Milberg Weiss.

I. THE OLD SYSTEM: THE RISE OF MILBERG WEISS

Understanding Milberg Weiss's fraud is possible only if one understands the system in which the fraud occurred. That system—class action securities lawsuits—has been one of the most lucrative and controversial areas of American law since its emergence in the 1970s. Until 1995, when Congress passed the Private Securities Litigation Reform Act, securities class actions were a race to the courthouse for both the industrious and the unscrupulous plaintiffs' attorney. If an attorney could win that race (that is, file the first lawsuit), the chances of being appointed lead counsel and controlling the litigation were substantial. Part I explains this system and Milberg Weiss's position in it. It discusses the history of Milberg Weiss and William Lerach, the concept of a strike suit, and the PSLRA.

A. *Milberg Weiss, Securities Class Actions, and William Lerach*

Based in New York City, the plaintiffs' firm Milberg Weiss was founded in 1965 to represent consumers and investors against American business interests in securities-fraud lawsuits.¹⁹ In pursuing securities fraud, the firm's founding partners, Lawrence Milberg and Melvyn Weiss,²⁰ operated on the outskirts of what was viewed as

19. Milberg, Our Firm: About Milberg, <http://www.milberg.com/firm/firm.aspx> (last visited Nov. 16, 2008).

20. Martha Neil, *Milberg Weiss on the Hot Seat: Should Law Firms Ever Be Indicted?*, A.B.A. J., Dec. 2006, at 34, 36.

respectable by the legal profession of the time.²¹ Milberg Weiss remained a small firm throughout the early 1970s because firms handling this type of work had difficulty building substantial client bases that could support a large office of litigators.²² Nor was the practice particularly lucrative—securities cases, already few in number, rarely reached trial as defendant companies outlasted and outspent the plaintiff investors until the suits disappeared.²³

Times changed, however; following the 1966 amendment to Rule 23 of the Federal Rules of Civil Procedure²⁴ and the 1971 Supreme Court ruling in *Superintendent of Insurance v. Bankers Life & Casualty Co.*,²⁵ securities litigation began to prosper in the early 1970s.²⁶ In *Superintendent of Insurance*, the Court held that a private action could be initiated under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act)²⁷ to redress securities fraud.²⁸ Although the law had technically recognized private actions twenty-five years prior to *Superintendent of Insurance*,²⁹ the Court's pronouncement that the securities laws "must be read flexibly, not

21. See Elkind, *supra* note 6, at 194 ("At the time shareholder litigation was a backwater, its practitioners viewed as bottom feeders.").

22. See *id.* (noting that early firms focusing on securities work were "invariably small and underfunded").

23. *Id.*

24. See FED. R. CIV. P. 23 advisory committee's notes to 1966 amendment (explaining the advisory committee's motivations for a rule using more "practical" and less "abstract" language to describe the occasions for using the class action device); Milberg, *supra* note 19 ("In the Firm's early years, its founding partners built a new area of legal practice in representing shareholders' interests under the then recently amended Rule 23 of the Federal Rules of Civil Procedure, which allowed securities fraud cases, among others, to proceed as class actions.").

25. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

26. Kamerman, *supra* note 8, at 857.

27. 15 U.S.C. § 78j(b) (2006).

28. *Superintendent of Ins.*, 404 U.S. at 12–13 ("The crux of the present case is that [the private company] suffered an injury as a result of deceptive practices touching its sale of securities as an investor. . . . 'In this situation the private right of action recognized under Rule 10b-5 is available as a remedy for the corporate disability.'" (citation omitted) (quoting *Shell v. Hensley*, 430 F.2d 819, 827 (5th Cir. 1970))).

29. See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 366 (1991) (Stevens, J., dissenting). As Justice Stevens noted,

The private cause of action for violating § 10(b) was first recognized in *Kardon v. National Gypsum Co.* In recognizing this implied right of action, Judge Kirkpatrick merely applied what was then a well-settled rule of federal law. As was true during most of our history, the federal courts then presumed that a statute enacted to benefit a special class provided a remedy for those members injured by violations of the statute.

Id. (citation omitted) (citing *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946)).

technically and restrictively”³⁰ seemed to be a boon for securities class actions.³¹ In this new era of private actions, plaintiffs’ attorneys now could couple private suits alleging misrepresentation of material facts under Section 11 of the Securities Act of 1933,³² Section 10(b) of the Exchange Act,³³ or specific Securities and Exchange Commission (SEC) rules³⁴ (for example, Rule 10b-5)³⁵ with the class action mechanism to pose a considerable financial threat to large corporations. As a result, a “significant portion of the private litigation under the securities laws occur[red] through . . . class action[s].”³⁶ A class of defrauded investors could recover their losses resulting from corporate misstatements or omissions directly from the corporate coffers.³⁷ Because these suits pitted stockholders (the owners) against their own company, many business interests viewed (and view) these suits as a blight on the American market system.³⁸ Most often, plaintiffs filed suit immediately after a significant drop in a company’s stock price or the release of news extremely detrimental to the interests of stockholders, with little time for a thorough

30. *Superintendent of Ins.*, 404 U.S. at 12.

31. See Douglas Martin, *The Rise and Fall of the Class-Action Lawsuit*, N.Y. TIMES, Jan. 8, 1988, at B7 (noting an increase of class actions in the early 1970s followed by a decrease as courts began to institute stricter standards). But see Thomas M. Jones, *An Empirical Examination of the Incidence of Shareholder Derivative and Class Action Lawsuits, 1971–1978*, 60 B.U. L. REV. 306, 306–07, 321 (1980) (suggesting that shareholder litigation only marginally increased during the 1970s).

32. 15 U.S.C. § 77k (2006).

33. 15 U.S.C. § 78j(b).

34. Weiss & Beckerman, *supra* note 13, at 2054 n.1. This Note’s primary concern is *not* with the law behind securities lawsuits. For this Note’s purposes, Judge Henry Friendly’s summary of the law should suffice:

The purpose of § 10(b) and Rule 10b-5 is to protect persons who are deceived in securities transactions—to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be.

Chem. Bank v. Arthur Anderson & Co., 726 F.2d 930, 943 (2d Cir. 1984).

35. 17 C.F.R. § 240.10b-5 (2008).

36. JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, *SECURITIES REGULATION, CASES AND MATERIALS* 753 (5th ed. 2006).

37. ADAM C. PRITCHARD, *SHOULD CONGRESS REPEAL SECURITIES CLASS ACTION REFORM?* 4 (Cato Inst., Policy Analysis No. 471, 2003), available at <http://www.cato.org/pubs/pas/pa471.pdf>.

38. *Id.* at 3–4; Elkind, *supra* note 6, at 192 (reporting one venture capitalist’s description of Lerach as a “cunning economic terrorist”).

investigation into potential fraud.³⁹ With the potential monetary losses at trial often ranging into the billions, many suits settled quickly for only a fraction of their potential worth.⁴⁰

It was into this increasingly lucrative practice of law that a young attorney named William Lerach entered when Melvyn Weiss convinced him to join Milberg Weiss in 1976.⁴¹ Weiss believed that by recruiting talented lawyers from the defense bar, he could make the traditionally disparaged practice of securities litigation respectable and, more importantly, prosperous.⁴² This belief led him to recruit Lerach, then a young partner at Reed, Smith, Shaw & McClay in Pittsburgh.⁴³ At the time, Milberg Weiss was still relatively small and headed by founders Milberg and Weiss and another young attorney, David Bershad; “Milberg was the founder; Weiss was the driving force; Bershad managed the firm’s finances.”⁴⁴ Lerach conditioned his move to Milberg Weiss upon his opening a San Diego office for the firm, despite the fact that hardly any shareholder litigation occurred on the West Coast at the time.⁴⁵ “Milberg West,”⁴⁶ as the office

39. Weiss & Beckerman, *supra* note 13, at 2085–86; *see also infra* notes 71–77 and accompanying text.

40. *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 498 (1991) (“Although trial is our paradigm of how civil litigation resolves disputes, in reality only a tiny fraction of litigated cases—perhaps five percent or less—are actually tried to judgment. Most cases are resolved through settlement. Indeed, federal policy (and probably that of most states) favors settlement over trial, to such an extent that it is a ‘familiar axiom that a bad settlement is almost always better than a good trial.’” (quoting *In re Warner Commc’ns Sec. Litig.*, 618 F. Supp. 735, 740 (S.D.N.Y. 1985), *aff’d*, 798 F.2d 35 (2d Cir. 1986))).

41. *See* Drummond, *supra* note 17, at 24 (“Lerach made the jump to Milberg Weiss in March 1976, and Mel Weiss became his mentor.”); William Greider, *Is This America’s Top Corporate Crime Fighter?*, NATION, Aug. 5, 2002, at 11, 14 (“‘I saw in those days that, if the plaintiffs’ lawyers had two things—money and brains—they could do it. But money was the most important thing because the companies have the money.’ Milberg Weiss, which he joined in the late 1970s, has plenty of both.” (quoting William Lerach)); Timothy L. O’Brien, *Behind the Breakup of the Kings of Tort*, N.Y. TIMES, July 11, 2004, § 3 (Business), at 1 (“Mr. Lerach joined the firm in 1976 as Mr. Weiss’s pupil . . .”).

42. *See* Elkind, *supra* note 6, at 194 (“Weiss thought that if he could attract some good defense lawyers to his side, he could level the playing field and gain a measure of status, which he craved.”).

43. E-mail from William S. Lerach to author (Dec. 11, 2007, 14:02:19 EST) (confidential source on file with author) [hereinafter Lerach, First E-mail].

44. *Id.*

45. Elkind, *supra* note 6, at 194.

46. Lerach headed Milberg West from the late 1970s until 2004, when the firm, then Milberg Weiss Bershad Hynes & Lerach, formally split into two separate firms. *Milberg Weiss Becomes 2 Firms*, N.Y. TIMES, May 4, 2004, at C4. As a result of the split, the New York office became Milberg Weiss Bershad & Schulman, whereas Lerach’s West Coast operation became

became known, would eventually become the hub for shareholder litigation not only at Milberg Weiss but also nationwide, developing a reputation for aggressiveness and success representing investors.⁴⁷

After arriving in San Diego and establishing Milberg West, Lerach rapidly ascended the heights of the California plaintiffs' bar, establishing his reputation during a four-year ordeal known as the Pacific Homes case. In 1981, Lerach filed suit on behalf of two thousand retirees against Pacific Homes Corporation, which operated retirement homes, and the United Methodist Church.⁴⁸ At first glance, the church was unrelated to the bankruptcy, but Lerach sued anyway on the theory that it was the "sponsoring entity" of Pacific Homes.⁴⁹ After four years, three petitions to the Supreme Court, and four months of trial, the church settled with Lerach for \$21 million⁵⁰ in addition to undisclosed future payments.⁵¹ The large settlement vaulted Lerach into the national spotlight⁵² and firmly established Milberg Weiss as a force in California. Most importantly, though, the case foreshadowed what would become Lerach's approach to securities lawsuits—"dreaming up new types of claims and naming new kinds of defendants—not just companies, but their accountants, bankers, lawyers, and PR firms."⁵³ The case even had traces of

Lerach Coughlin Stoia & Robbins (Lerach Coughlin). *Id.* The federal indictment against Milberg Weiss this Note explores concerned only Milberg Weiss Bershad & Schulman, not Lerach Coughlin. The activities alleged in the indictment, however, occurred during the period when the firm was still together as Milberg Weiss Bershad Hynes & Lerach.

47. Lerach, First E-mail, *supra* note 43.

48. Drummond, *supra* note 17, at 24.

49. To understand how the appellate court understood Lerach's theory, see generally *Barr v. United Methodist Church*, 153 Cal. Rptr. 322 (Cal. Ct. App. 1979). "In describing [the features of its services], Pacific Homes referred to itself as being sponsored by the Southern California Arizona Conference of the United Methodist Church and offered a special program of assistance to help a limited number of United Methodists." *Id.* at 331; see also EDWARD M. GAFFNEY, JR. & PHILIP C. SORENSON, *ASCENDING LIABILITY IN RELIGIOUS AND OTHER NONPROFIT ORGANIZATIONS* 6, 7 (Howard R. Griffin ed., 1984) (describing Lerach's theory that "Pacific Homes Corporation was the agent and alter ego of each of the other defendants, and had acted with their permission, knowledge, and consent, and within the scope of their authority").

50. *Suit on Retirement Homes Settled*, N.Y. TIMES, Dec. 12, 1980, at A18.

51. Lerach, First E-mail, *supra* note 43. All told, the church paid more than \$42.5 million to its elderly residents in the years following the settlement. Drummond, *supra* note 17, at 24.

52. In addition to regional and national newspaper coverage of the settlement, the CBS newsmagazine 60 Minutes aired a special on the Pacific Homes case, stirring "fears . . . that the denomination might throw Pacific Homes residents out onto the street if they couldn't pay their fees." Tim Tanton, *United Methodists' Pacific Homes Saga Ends on an Up Note*, WORLDWIDE FAITH NEWS, Sept. 10, 1999, <http://www.wfn.org/1999/09/msg00109.html>.

53. Elkind, *supra* note 6, at 194.

Lerach's well-chronicled asperity toward the defendants he pursued; after the Pacific Homes case ended, Lerach hung two sketches in his San Diego office—one showed himself as Saint George, and the other caricatured the United Methodist Church as a dragon.⁵⁴

As the 1980s progressed and the technology boom in California matured, Lerach and Milberg Weiss began to home in on the burgeoning securities activities that accompanied the birth and growth of Silicon Valley's technology companies. Although the list of corporate defendants Lerach sued was a who's who of the Fortune 500, several of his cases from the late 1980s and early 1990s were particularly notable. Lerach and Milberg Weiss sued and won settlements against Nucorp Energy (\$42.5 million),⁵⁵ electronics and component producer Oak Industries (more than \$30 million),⁵⁶ Drexel Burnham Lambert and Michael Milken (exposing and proving the existence of the Drexel "Daisy Chain"),⁵⁷ Apple Computer (\$100 million judgment, which was later reduced on appeal),⁵⁸ and Charles Keating's American Financial Corporation (\$240 million paid to settle the investor class action stemming from the Lincoln Savings & Loan scandal).⁵⁹ Between 1989 and 1993 alone, Milberg Weiss and "other"⁶⁰ plaintiffs' firms in California filed class action suits against

54. Drummond, *supra* note 17, at 24.

55. Elkind, *supra* note 6, at 198–200 (detailing the story behind Lerach's \$42.5 million settlement, as well as the influence on the case of Daniel Fischel, future Dean of the University of Chicago Law School, who served as an expert witness for the defense).

56. Lerach, First E-mail, *supra* note 43. As part of the settlement, beyond monetary damages, the CEO of Oak Industries was barred from ever serving as an officer of a public company. *Id.* For further background on the litigation, see *In re Oak Indus. Sec. Litig.*, No. 83-0537-G(M), 1986 U.S. Dist. LEXIS 20942 (S.D. Cal. Aug. 29, 1986).

57. Lerach, First E-mail, *supra* note 43. Although unsubstantiated, the many settlements and suits against Drexel Burnham are thought to total more than \$1 billion. *Id.* The exact total paid to plaintiffs is unclear, although \$650 million has been reported. Jonathan Potts, *Lead Attorney*, PITT MAG., Mar. 2002, at 32, 33, available at <http://www.pittmag.pitt.edu/mar2002/feature4.html>. For more information on the chain of events leading to the bankruptcy of Drexel Burnham Lambert, see *The Collapse of Drexel Burnham Lambert: Dismantling a Once-Powerful House: Key Events for Drexel Burnham Lambert*, N.Y. TIMES, Feb. 14, 1990, at D4.

58. Lawrence M. Fisher, *The Pit Bull of Silicon Valley*, N.Y. TIMES, Sept. 19, 1993, at C4.

59. Lerach, First E-mail, *supra* note 43.

60. Journalists have reported that Lerach was almost always at least tangentially involved in securities suits filed in California, and it may be impossible to distinguish which suits, if any, Lerach did not have a hand in:

Many of those who spoke to *Fortune* about Lerach describe him in Godfather-like terms, likening him to a ruthless don, willing to do whatever it takes to protect and extend his turf. To that end, Lerach developed an unprecedented system in which other plaintiffs [*sic*] firms were expected to pay tribute to Milberg Weiss to do business in California.

fifty-three of California's one hundred largest high-tech companies.⁶¹ In 1993, Lerach told the *New York Times*, "I've been in 400 securities class actions,"⁶² while estimating that Milberg Weiss had distributed more than \$4 billion to investor-plaintiffs since the 1970s.⁶³

B. *The Early 1990s: Strike-Suit King*

The linchpin of Lerach's success in the early 1990s was his mastery of the so-called class action strike suit.⁶⁴ The term "strike suit" referred to the *immediate* filing of a class action lawsuit against a publicly traded company alleging securities fraud just one day or several days after a significant downward drop in the company's stock price.⁶⁵ To file a lawsuit so quickly, plaintiffs' attorneys often took on the nontraditional role of informing their clients of possible fraud. Only on the rarest occasion would a stockholder suspect that there was a possible violation of securities laws; rather, "the usual pattern [was] for a lawyer who specialize[d] in representing plaintiffs to take the initiative."⁶⁶ At times, suits were filed in less than twenty-four hours.⁶⁷ Client ignorance "left [the attorney] with largely unfettered discretion in deciding what cases to bring, how to prosecute those cases, and how to settle them."⁶⁸

The late 1980s and early 1990s "were the golden age of the strike suit, a period when California's high-tech companies complained bitterly that Lerach would file a securities fraud claim the moment they missed a quarterly earnings projection."⁶⁹ To Lerach, however,

Elkind, *supra* note 6, at 192.

61. Damon Darlin, *A Nice, Clean California Industry*, FORBES, Aug. 26, 1996, at 46, 46-47.

62. Fisher, *supra* note 58.

63. *Id.*

64. See Drummond, *supra* note 17, at 24 (describing Lerach's methods to ensure that he had priority as lead counsel among the California plaintiffs' bar).

65. *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 108 (1993) [hereinafter *Senate Hearings*] (statement of Richard J. Egan, Chairman of the Board, EMC Corp.); see also Weiss & Beckerman, *supra* note 13, at 2060, 2084-86 ("We believe it is appropriate to describe a class action as a 'strike suit' if a plaintiff's attorney initiates the action without reasonable grounds to believe it has merit . . .").

66. Weiss & Beckerman, *supra* note 13, at 2060.

67. See *id.* at 2060 n.32 ("[O]f 46 class actions studied, 12 were filed within one day and another 30 were filed within one week of publication of unfavorable news about defendant corporation." (citing Milt Policzer, *They've Cornered the Market: A Few Firms Dominate the Derivative-Suit Arena*, NAT'L L.J., Apr. 27, 1992, at 1, 34)).

68. Perino, *supra* note 15, at 919-20.

69. Drummond, *supra* note 17, at 24.

the high-tech boom was an ideal situation for fraud to ferment. As he once told *The New York Times*, “[t]he compensation at high-tech, high-growth companies is disproportionately weighted toward stock options It creates a corporate culture where the year-to-year and quarter-to-quarter income levels of executives are dependent on the price of the stock.”⁷⁰ Lerach believed he was combating a corporate culture of greed and cutthroat treachery that left investors with empty portfolios and CEOs unjustly enriched.⁷¹ The strike suit was his weapon.

Many academics used “strike suit” as a pejorative term for class actions in the early 1990s because the merits of a case were viewed as subordinate to the pecuniary interests of the plaintiffs’ attorney.⁷² The term “professional plaintiffs” became widely used to describe individuals “who owned a few shares of stock in each of a large number of companies and who were willing to have their names attached to complaints.”⁷³ To academics and corporations, professional plaintiffs were either pawns or accomplices in their attorneys’ quests for contingency-fee riches:

The portrait of the typical named plaintiff that emerges from the case law demonstrates that plaintiffs’ attorneys recruit most of the investors in whose names they initiate class actions. . . . [P]laintiffs are poorly informed about the theories of their cases, are totally ignorant of the facts, or are illiterate concerning financial matters. In many others, the named plaintiff has a close relationship to the plaintiff’s lawyer or her firm. The most common recruitment

70. Fisher, *supra* note 58. Scholarly literature has, to some degree, corroborated Lerach’s theory that the nature of high-technology firms makes them particularly likely to commit securities fraud. See Perino, *supra* note 15, at 957–62 (noting that “executives of high-technology firms appear to receive a greater proportion of their compensation in stock options and therefore may engage in more trading” and that the firms themselves, given their new entry to the securities market, are less adept at forecasting financial information).

71. See Greider, *supra* note 41, at 12 (“Corporate moguls, Lerach explained, have a character flaw that is often fatal. ‘The CEO ultimately gets brought down by the very personality characteristics that made him successful in the first place How did these guys get to the point where they control a big public company? It’s not because they take no for an answer.’” (quoting William Lerach)).

72. See *supra* note 65.

73. R. Chris Heck, Comment, *Conflict and Aggregation: Appointing Institutional Investors as Sole Lead Plaintiffs Under the PSLRA*, 66 U. CHI. L. REV. 1199, 1202 (1999).

practice followed by plaintiffs' attorneys apparently is to maintain a list of potential plaintiffs and their stockholdings.⁷⁴

Although Lerach disputed this characterization of his relationship with clients,⁷⁵ he acknowledged that time was of the utmost importance in the competitive plaintiffs' bar: "We want to control the case. We believe we can do the best job and we want to be first to file so that we can control the case [T]he courts historically have rewarded the first filed case with control of the case as lead counsel."⁷⁶ In an ultracompetitive environment in which courts were unwilling to dirty their hands working out which firm would best represent a class, judges chose lead counsel using the clearest available signal: which attorney won the race to the courthouse by filing first.⁷⁷ The competitive conditions thus led to two starkly different opinions of strike suits: business interests and the academy regarded them as the product of dishonest plaintiffs' attorneys manipulating clients for the lawyers' personal pecuniary gains, whereas plaintiffs' attorneys understood strike suits as the reality of a competitive market favoring alacrity.

C. *The Private Securities Litigation Reform Act of 1995*

The perception of strike suits in the early 1990s was overwhelmingly negative, with plaintiffs' attorneys accused of both fomenting unnecessary litigation⁷⁸ and breaching ethical standards in their solicitation⁷⁹ and prosecution of lawsuits.⁸⁰ Additionally, big

74. Weiss & Beckerman, *supra* note 13, at 2060–61 (footnotes omitted); *see also* Perino, *supra* note 15, at 919 ("The plaintiffs' attorney is supposed to act in the best interests of the class. But the typical members of the class were generally thought to have very small stakes in the outcome of the case—too small to make monitoring the attorney a cost-effective option.").

75. *See, e.g.,* Policzer, *supra* note 67, at 1, 34 (writing that Lerach denied maintaining a list of professional plaintiffs and claimed that clients often sought his help within hours of a stock price dropping). *But see* Weiss & Beckerman, *supra* note 13, at 2059 n.28 ("Some firms repeatedly initiate class actions in the names of 'professional' plaintiffs who have widely dispersed and thinly spread stock holdings.").

76. *Senate Hearings, supra* note 65, at 80 (testimony of William S. Lerach).

77. *See* Weiss & Beckerman, *supra* note 13, at 2099 ("[C]ourts virtually never consider the possibility that one aspiring lead plaintiff is more likely than another to monitor her lawyer's conduct of the litigation.").

78. *See* Perino, *supra* note 15, at 914 n.2 (describing the type of frivolous litigation Congress targeted).

79. *See* Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, 60 LAW & CONTEMP. PROBS. 167, 172, 181 (Autumn 1997) (reporting that traditional rules prohibited lawyers from filing lawsuits first and then offering plaintiffs the opportunity to opt out).

business, the courts, and Congress all viewed the existence and use of “professional plaintiffs” as problematic to the interests of justice.⁸¹

To remedy the perceived faults with the securities class action system, especially the problems with selecting lead plaintiffs, Congress passed the Private Securities Litigation Reform Act of 1995.⁸² The PSLRA reflected assumptions that (1) “plaintiffs’ attorneys initiated and managed securities class actions”;⁸³ (2) “attorneys had incentives to pursue claims that were not optimal for corporations, shareholders, and the larger society”;⁸⁴ and (3) “settlement was independent of the merits.”⁸⁵ Overall, the PSLRA primarily targeted perceived excesses in the pursuit of lead-counsel appointment and the use of professional plaintiffs.

The PSLRA modified securities law in several divergent ways. First, Congress made substantive and procedural modifications meant to affect *all* plaintiffs, not just professional plaintiffs (for example, changes in the scienter requirement, a heightened pleading standard, a cap on damages, and a stay of discovery pending a motion to dismiss).⁸⁶ Second, Congress made targeted procedural reforms to specifically remove incentives for professional plaintiffs and their lawyers (for example, limitations on the number of complaints

80. See Junda Woo, *Judges Show Growing Skepticism in Class-Action Securities Cases*, WALL ST. J., Jan. 11, 1995, at B8 (reporting district judges’ disapproval of identical filings by different plaintiffs’ firms both (coincidentally or not) alleging that Phillip Morris engaged in deceptive practices to enhance their stature “in the toy industry” (emphasis omitted) (quoting Richard Owen, J., U.S. Dist. Court, S. Dist. of N.Y.)). In the lawsuit reported in Woo’s article, Milberg Weiss was one of several firms representing the plaintiffs. *Id.*

81. See *In re Urcarco Sec. Litig.*, 148 F.R.D. 561, 563 (N.D. Tex. 1993) (dismissing the suit and noting that the “[p]laintiffs seek to represent a class of investors who were allegedly defrauded by the concerted bad acts of this litany of wrong-doers, and have among their ranks one of the unluckiest and most victimized investors in the history of the securities business, one Mr. Steven G. Cooperman, who spends a good deal of his time being a plaintiff in class action securities fraud suits.”), *aff’d sub nom. Melder v. Morris*, 27 F.3d 1097 (5th Cir. 1994); S. REP. NO. 104-98, at 4 (1995) (“All too often, the same ‘professional’ plaintiffs appear as name plaintiffs in suit after suit.”); *supra* note 39 (making this point with respect to big business).

82. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.); see also H.R. REP. NO. 104-369, at 32, 31–36 (1995) (Conf. Rep.) (“House and Senate Committee hearings on securities litigation reform demonstrated the need to reform abuses involving the use of ‘professional plaintiffs’ and the race to the courthouse to file the complaint.”).

83. Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1490 (2006).

84. *Id.*

85. *Id.*

86. *Id.* at 1493–94.

individuals could file, new penalties for frivolous filings, and changes to the way courts chose lead plaintiffs).⁸⁷ Given its applicability to lead counsel selection and Milberg Weiss, this Section only explores the second category of changes, which addresses professional plaintiffs.

The PLSRA includes several provisions empowering investors to control more aspects of litigation, which Congress hoped would rein in the plaintiffs' bar.⁸⁸ These new rules favor appointing institutional investors as lead plaintiff by removing the benefits of filing a lawsuit first.⁸⁹ Institutional investors, such as pension and mutual funds, insurance companies, and banks,⁹⁰ manage the money of thousands of investors, and were presumed to have a greater incentive to manage the behavior of class counsel than individual professional plaintiffs.⁹¹ Under the new lead-plaintiff provision, the trial court selects lead plaintiff—the “most adequate plaintiff”—using certain criteria the PSLRA establishes.⁹² Based on Professors Weiss and Beckerman's recommendations in the *Yale Law Journal*,⁹³ courts applying the PSLRA must presume that the most adequate plaintiff is the one who has “the largest financial interest in the outcome of the case.”⁹⁴ So that large institutions can learn of opportunities to enter these cases, the first plaintiff to file a suit also must give nationwide notice that the plaintiff has commenced the action.⁹⁵ Congress's encouragement of institutional investors to become lead plaintiffs was based on the assumption that large mutual funds and public-pension organizations have the resources and sophistication to control plaintiffs' attorneys

87. *Id.* at 1494.

88. Fisch, *supra* note 79, at 176.

89. 15 U.S.C. § 77z-1(a)(3)(B) (2006).

90. Weiss & Beckerman, *supra* note 13, at 2091.

91. *See id.* at 2095 (“Institutional investors with large stakes in class actions surely are more capable than typical figurehead plaintiffs of effectively monitoring how plaintiffs' attorneys conduct such litigation. Institutions' large stakes give them an incentive to monitor, and institutions have or readily could develop the expertise necessary to assess whether plaintiffs' attorneys are acting as faithful champions for the plaintiff class.”).

92. 15 U.S.C. § 77z-1(a)(3)(B)(iii)(I).

93. *See* S. REP. NO. 104-98, at 11 n.32 (1995) (“This article provided the basis for the ‘most adequate plaintiff’ provision.” (citing Weiss & Beckerman, *supra* note 13)).

94. Perino, *supra* note 15, at 923.

95. 15 U.S.C. § 77z-1(a)(3)(A); *see also* S. REP. NO. 104-98, at 11 (“The Committee intends ‘publication’ to encompass a variety of mediums, including wire, electronic, or computer services.”).

and to guarantee that attorney behavior is consistent with the interests of the class.⁹⁶

Congress also prevented a person from serving as the class representative for more than five lawsuits in a three-year period.⁹⁷ The PSLRA further prohibits class representatives from receiving anything but a pro rata share of settlements or judgments.⁹⁸ Together, Congress aimed these provisions to combat the problems of having uninformed or repeat plaintiffs or plaintiffs whose allegiances are to their lawyers and not their fellow class members.⁹⁹

Congress passed the PSLRA with Lerach and Milberg Weiss in its headlights. As one Silicon Valley securities lawyer told *Fortune* magazine, “[t]he way to understand the [PSLRA] . . . is [as] a bill of attainder against Bill Lerach.”¹⁰⁰ Not coincidentally, Professor Elliott Weiss, reciting the events that transformed his and Professor Beckerman’s *Yale Law Journal* article into the lead-plaintiff provision of the PSLRA, cites his experience as a defense litigator in a New York securities fraud case as stimulating his desire for reform.¹⁰¹ Milberg Weiss was lead counsel for the plaintiffs in that case.¹⁰²

96. James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1593–97 (2006) (“[P]laintiffs’ lawyers would ‘no longer find it necessary to race to the courthouse’ but could instead more carefully investigate the merits of potential claims before deciding whether to file complaints. Furthermore, institutional investors might be solicited by plaintiffs’ law firms to become lead plaintiffs, but, as more experienced and sophisticated clients, such institutions would be better able to select competent class counsel.” (footnote omitted) (quoting Weiss & Beckerman, *supra* note 13, at 2106)). Included in this oversight assumption was the belief that large institutions would be more likely to negotiate or demand a reduction in attorney’s fees. *Id.*

97. 15 U.S.C. § 77z-1(a)(3)(B)(vi).

98. *Id.* § 77z-1(a)(4).

99. See Cox & Thomas, *supra* note 96, at 1593–97 (“[S]ince institutional investors who manage other people’s money have fiduciary obligations to take ‘reasonable steps to realize on claims that will advance the interests of beneficiaries,’ proponents of the PSLRA structure were optimistic that institutional investors would become involved in these cases.” (footnote omitted) (quoting Keith L. Johnson, *Deterrence of Corporate Fraud Through Securities Litigation: The Role of Institutional Investors*, 60 LAW & CONTEMP. PROBS. 155, 157 (Autumn 1997))).

100. Elkind, *supra* note 6, at 204.

101. Elliott J. Weiss, *The Lead Plaintiff Provisions of the PSLRA After a Decade, or “Look What’s Happened to My Baby,”* 61 VAND. L. REV. 543, 545–46 (2008).

102. *In re Warner Commc’ns Sec. Litig.*, 618 F. Supp. 735, 735 (S.D.N.Y. 1985), *aff’d*, 798 F.2d 35 (2d Cir. 1986).

II. THE MILBERG SYSTEM: KICKBACKS AND FRAUD

At the time the lead-plaintiff provision was proposed and incorporated into the PSLRA, class action reformers believed they completely understood the workings of the plaintiffs' bar.¹⁰³ Prior to the PSLRA, it was widely believed that plaintiffs' lawyers had close, repeat relationships with certain clients or simply tricked unwitting clients into filing lawsuits. The 2006 federal indictment of Milberg Weiss for paying clients to file lawsuits, however, added a previously unknown wrinkle to the dynamics of the attorney-client relationship.

To establish the ultimate conclusion that reformers based the lead-plaintiff provision of the PSLRA on incorrect assumptions, Part II gives the factual background about the actual operations of Milberg Weiss (that is, the story of kickbacks). Using Milberg Weiss's federal indictment as a guide, this Part chronicles the scandal and offers an example of how the firm typically arranged kickbacks. By understanding the nuances of Milberg Weiss's operations, one begins to appreciate how the PSLRA's lead-plaintiff provision misdiagnosed the disease and prescribed the wrong medicine.

To counter the natural rebuttal that understanding the operations of one firm is insufficient to understand the workings of the plaintiffs' bar, Part II also includes an analysis of Milberg Weiss's market share in securities class action litigation. The numbers show that Milberg Weiss came to control more than half of the class actions in the United States. These data prove that in many ways Milberg Weiss *was* the securities plaintiffs' bar, and a problem with Milberg Weiss was a problem with the entire bar.

A. *The Kickback Scandal: How Milberg Weiss Really Operated*

The story of the Milberg Weiss kickbacks truly begins at the end of the conspiracy, when, finally, everyone in the plaintiffs' and defense bars took notice of a practice widely rumored to have existed for years.¹⁰⁴ In May of 2006, a federal grand jury in Los Angeles indicted Milberg Weiss and two members of the firm's executive committee, David Bershada and Steven Schulman, for participation in

103. E-mail from Elliott Weiss, Charles E. Ares Professor Emeritus, James E. Rogers Coll. of Law, Univ. of Ariz., to author (Dec. 13, 2007, 09:02:23 EST) (on file with the *Duke Law Journal*) ("Our article contained pretty much all we knew about attorney-client relationships involving the plaintiffs' bar. We understood that some firms had 'stables' of clients [*sic*], but that was about all.").

104. Telephone interview with confidential source (Dec. 13, 2007).

a kickback scheme alleged to have begun more than twenty years earlier.¹⁰⁵ Neither Melvyn Weiss nor William Lerach, who had left Milberg Weiss in 2004 to start his own firm, Lerach Coughlin,¹⁰⁶ was named in the original indictment; however, both men were identified repeatedly as Partner A (Weiss) and Partner B (Lerach)¹⁰⁷ in the charging document. The indictment alleged bribery, fraud, perjury, conspiracy, and obstruction of justice¹⁰⁸ from the firm's (and the lawyers') participation in a scheme in which clients "received secret kickback payments to serve, or cause friends and relatives to serve, as named plaintiffs in lawsuits filed by Milberg Weiss."¹⁰⁹ In January of 2007, a second superseding indictment was issued naming Melvyn Weiss as a defendant and further detailing the role of the firm's executive committee in perpetrating the fraud.¹¹⁰ Between the late 1970s and 2005, Milberg Weiss allegedly paid more than \$11.3 million in kickbacks to clients from its own legal fees—fees that totaled \$251 million from cases that settled for billions of dollars.¹¹¹

The alleged kickbacks went primarily to individuals who agreed to serve as lead plaintiffs in New York, California, and Florida and to smaller law firms that served as fronts to launder money from Milberg Weiss to individual plaintiffs.¹¹² The indictment named several defendants, generally well-off individuals capable of maintaining broad stock portfolios, who cooperated with Milberg Weiss to serve repeatedly as lead plaintiffs. In California, Seymour Lazar, a wealthy property owner in Palm Springs,¹¹³ and Dr. Steven Cooperman, a Los Angeles ophthalmologist,¹¹⁴ both served as repeat plaintiffs for Milberg Weiss actions.¹¹⁵ The latter, Cooperman,

105. Julie Creswell, *U.S. Indictment for Big Law Firm in Class Actions*, N.Y. TIMES, May 19, 2006, at A1.

106. Elkind, *supra* note 10, at 169.

107. *Id.* at 156.

108. First Superseding Indictment, *supra* note 1, at 10–89, 93.

109. Press Release, Thom Mrozek, U.S. Attorney's Office for the Cent. Dist. of Cal., Melvyn Weiss, Co-Founder of Milberg Weiss Law Firm, Indicted in Secret Kickback Scheme Involving Named Plaintiffs in Class-Action Lawsuits (Jan. 20, 2007), available at <http://online.wsj.com/public/resources/documents/milbergweisspr.pdf>.

110. Second Superseding Indictment, *supra* note 10, at 13–14.

111. *Id.* at 14.

112. *Id.* at 9–13.

113. *Id.* at 2.

114. *Id.* at 3.

115. For Judge Kendall's observation in *In re Urcarco Securities Litigation*, 148 F.R.D. 561, 563 (N.D. Tex. 1993), that Cooperman was one of the unluckiest investors alive, see *supra* note 81.

revealed the kickback arrangement to federal prosecutors in an effort to reduce his sentence for insurance fraud in 1999.¹¹⁶ According to Cooperman, Milberg Weiss paid him a portion of its attorney's fees when he served as lead plaintiff in class actions.¹¹⁷ To position Cooperman as a plaintiff, Lerach encouraged him to purchase a diversified portfolio of stocks.¹¹⁸ Cooperman told federal prosecutors that he or his family and friends had participated in approximately seventy lawsuits¹¹⁹ and received \$6.2 million for their efforts.¹²⁰

One of the cases listed in the indictment against Milberg Weiss, *Steven Cooperman v. Newhall Land & Farming Co.*,¹²¹ illustrates both how the arrangement operated and the methods Milberg Weiss used to conceal payments. According to the indictment, in April 1988, Lerach informed Cooperman that "Milberg Weiss would pay him and [a relative] a percentage of Milberg Weiss's fee"¹²² in a case against Valencia, California-based land developer Newhall Land and Farming Company if he served as lead plaintiff in a class action suit.¹²³ In early 1988, to prevent hostile takeovers by corporate raiders, Newhall planned to adopt new partnership agreement provisions and issue new stock, which would have diluted the value of outstanding shares.¹²⁴ Long-term investors in Newhall expressed concern over management's decisions, which they viewed as self-serving modifications to save executive jobs instead of maximizing stock

116. Elkind, *supra* note 10, at 160.

117. *Id.* at 163.

118. *Id.*

119. *Id.*

120. Second Superseding Indictment, *supra* note 10, at 13.

121. *Steven Cooperman v. Newhall Land & Farming Co.*, No. CA001093 (Cal. Super. Ct. filed Apr. 19, 1988), *cited in* Second Superseding Indictment, *supra* note 10, at 27.

122. Second Superseding Indictment, *supra* note 10, at 27.

123. See Briefly, L.A. TIMES, Apr. 21, 1988, at 2 (reporting that shareholders sued Newhall and William Lerach represented the plaintiffs).

124. Because Newhall was a partnership with publicly traded units, it was possible for outsiders to acquire an interest in the company and exercise control over management decisions, thus exposing the firm to takeover. James F. Peltz, *Newhall Land, A Partnership with Takeover Jitters, Seeks Defense*, L.A. TIMES, Apr. 14, 1988, at 1. The L.A. Times reported, "The proposals also gives [*sic*] Newhall Management the authority, without prior approval by unit-holders, to issue new classes of units that could be used to thwart a raider. But Newhall also acknowledged that the new stock would dilute the ownership of its current unit-holders, which is particularly annoying to . . . Newhall investors." *Id.*

price.¹²⁵ Local newspapers reported these developments in the weeks prior to, and during, the time Lerach contacted Cooperman.¹²⁶

According to the federal indictment, Cooperman probably acquired an interest in the company in early April,¹²⁷ around the time local newspaper coverage began, and Lerach filed suit on April 19, 1988, “alleg[ing] that the proposals would ‘make any takeover of Newhall absolutely impossible’ and [were] meant to entrench current management.”¹²⁸ Although Newhall had outstanding shares valued at more than \$754 million,¹²⁹ the 105-year-old California company, with major institutional investors across the United States,¹³⁰ fell prey to a Los Angeles ophthalmologist who probably had owned stock in the company for less than a month.

The indictments against Lerach and Milberg Weiss rely on court filings from the *Newhall* case to build the government’s case against Lerach and the firm. According to prosecutors, Cooperman represented to the court in those filings that “Plaintiffs . . . do not have interests antagonistic to or in conflict with those they represent as class representatives.”¹³¹ That misrepresentation became (eighteen years later) Overt Act No. 171 in furtherance of the conspiracy to obstruct justice, commit perjury and mail fraud, and engage in illegal kickbacks in the indictment filed against Milberg Weiss.¹³² Within six months of Cooperman filing the *Newhall* lawsuit, the company agreed

125. *Id.* One Chicago securities trader whose firm owned more than \$20 million of Newhall stock complained that Newhall “[wa]s attempting to do something to really hurt our investment.” *Id.*

126. *Id.*

127. *See* Second Superseding Indictment, *supra* note 10, at 27. The indictment indicates that *Newhall* was Lerach’s first arrangement with Cooperman. *Id.* The indictment states, “Between in or about April and November 1988, Lerach told Cooperman that Milberg Weiss would pay [them] a percentage of Milberg Weiss’s fee in [*Newhall*].” *Id.* Since the lawsuit was filed on April 19, Lerach and Cooperman would have had to agree to file the lawsuit sometime prior to this date, but still in or about April. The local newspapers reported on the events approximately one week earlier. It seems reasonable to conclude from the “in or about” language that Cooperman purchased the stock in April to position himself for the lawsuit.

128. Briefly, *supra* note 123 (reporting William Lerach’s description of the lawsuit and his concerns about Newhall’s planned corporate defensive maneuvers).

129. This figure was reached by multiplying Newhall’s 19.8 million total shares with its price in April 1988 of \$38.125. *See* Peltz, *supra* note 124 (reporting Newhall’s total outstanding shares and share price in April 1988).

130. *See id.* (listing a few of Newhall’s major shareholders).

131. First Superseding Indictment, *supra* note 1, at 64 (alteration in original) (quoting Steven Cooperman v. Newhall Land & Farming Co., No. CA001093 (Cal. Super. Ct. filed Apr. 19, 1988)).

132. *Id.*

to a settlement, under which it would repurchase \$40 million of its own stock, make “‘minor changes’ in three of five anti-takeover provisions that [stockholders] approved,”¹³³ and pay the plaintiff’s attorney’s fees of approximately \$2 million¹³⁴ (\$1.8 million of which went to Milberg Weiss).¹³⁵

The indictment contended that soon after the fee was awarded in late 1988 or early 1989, Cooperman asked that Lerach pay him his portion quickly.¹³⁶ Lerach, Melvyn Weiss, and David Bershad agreed to pay Cooperman his promised portion (between 5 and 10 percent) by “disguising the payment as a refundable option on a painting Cooperman owned,”¹³⁷ Pablo Picasso’s 1932 *Reclining Nude*.¹³⁸ Thereafter, they paid Cooperman \$175,000 by personal check.¹³⁹ Although Cooperman and Lerach had filed papers with the court stating that Cooperman’s interest *was not antagonistic* to the unnamed class plaintiffs,¹⁴⁰ Cooperman walked away with a substantial amount of his attorney’s money in his pocket, despite his negligible and brief ownership in Newhall. Milberg Weiss took more than \$1.5 million in fees for only five months of representation, even after the payments to Cooperman.

Milberg Weiss’s false representations to the court and the violation of the fiduciary duty owed to the absent unnamed parties, not the “strike suit,” put the firm on the wrong side of the law in *Newhall* and at least 180 other cases.¹⁴¹ Both the named plaintiff in a class action lawsuit and the attorneys for that plaintiff owe the absent class members a fiduciary duty *not* to put the named plaintiff’s interest first, give preferential treatment to the named plaintiff, or act in any manner intended to deceive the court.¹⁴² And although the

133. James F. Peltz, *Newhall Agrees to Buy Back Units to Help Settle Lawsuit*, L.A. TIMES, Oct. 1, 1998, at 4.

134. *Newhall Land Plan to Buy Back Investor Units OK’d*, L.A. TIMES, Nov. 22, 1988, at 9F.

135. First Superseding Indictment, *supra* note 1, at 64 (Overt Act No. 173).

136. Second Superseding Indictment, *supra* note 10, at 28 (Overt Act No. 17).

137. *Id.* (Overt Act No. 19).

138. *Id.* at 29 (Overt Act No. 21).

139. *Id.* (Overt Act No. 21).

140. First Superseding Indictment, *supra* note 1, at 64 (citing *Steven Cooperman v. Newhall Land & Farming Co.*, No. CA001093 (Cal. Super. Ct. filed Apr. 19, 1988)).

141. Elkind, *supra* note 10, at 156 (reporting the number of cases).

142. See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 549 (1949) (“Likewise, a stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character. He sues, not for himself alone, but as representative of a class comprising all who are similarly situated.”);

PSLRA was the first time that Congress *explicitly* forbade kickbacks to plaintiffs,¹⁴³ given how the payments were concealed, the attorneys involved in making and concealing kickbacks understood the illicit nature of their dealings with Cooperman.

Aside from the bogus down payment for the Picasso painting in *Newhall*, the government's case against Milberg Weiss reads like a Hollywood thriller when naming the methods Milberg Weiss used to cover its tracks and make its payments. For instance, Steven Schulman, a partner in Milberg Weiss's New York office, procured new clients by paying stockbrokers for client lists.¹⁴⁴ In his testimony to the government, one stockbroker (only identified as Stockbroker A) recounted how Schulman and he would meet at budget motels in Newburgh, New York, (seventy miles north of Schulman's New Jersey home) and place their briefcases under the table to make the money exchange for these lists.¹⁴⁵

MODEL RULES OF PROF'L CONDUCT R. 3.3(a) (2007) ("A lawyer shall not knowingly . . . make a false statement of fact or law to a tribunal . . ."). Prosecutors stressed this point in the second superseding indictment:

Because the conduct and decisions of a named plaintiff in a class action or shareholder derivative action affect the interests and rights of class members or shareholders who are not before the court, the named plaintiff owes these absent class members or shareholders certain fiduciary duties. As a result of these legally imposed duties, a named plaintiff, among other things: (a) may not place his or her own interests above those of absent class members or shareholders; (b) may not act in a deceitful or unethical manner toward the court or the absent class members or shareholders; and (c) is required to disclose to the court any fact that reasonably could affect his or her ability to fairly or adequately represent the interests of the absent class members or shareholders.

Second Superseding Indictment, *supra* note 10, at 6.

143. See 15 U.S.C. § 77z-1(a)(2)(A)(vi) (2006) ("[T]he plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court . . .").

144. *US Says Milberg Weiss Partner Literally Passed Money "Under the Table,"* FORTUNE, July 12, 2007, <http://legalpad.blogs.fortune.cnn.com/2007/07/12/us-says-milberg-weiss-partner-literally-passed-money-under-the-table/>. One New York defense attorney reflected that the common presumption in the early 1990s was that Milberg Weiss paid stockbrokers for information and then contacted clients, *see* Telephone Interview with confidential source (Dec. 13, 2007), not that the firm paid clients.

145. [Attorney:] Okay. Tell us, in as much detail as you can, the actual way in which the cash was physically transferred from Mr. Schulman to you, and in what form it was provided to you in terms of packaging or the like.

[STOCKBROKER A:] We would be sitting at a table, having breakfast, and Mr. Schulman had a briefcase that was under the table, and I had my briefcase under the table. I would take out what was in his briefcase and put it into my briefcase, give him back his briefcase, close up my briefcase. And there were packages of hundred dollar bills, packs of hundred dollar bills.

[ATTORNEY:] So the money was passed, literally, underneath the table?

[STOCKBROKER A:] Under the table.

Aside from the excesses in the Schulman example, Milberg Weiss generally transferred money to clients by first sending it to small law firms in various parts of the country.¹⁴⁶ Milberg Weiss could then record these payments in the firm's accounting books as "referral fees" paid,¹⁴⁷ which is a permissible use of fees awarded in a case.¹⁴⁸ The smaller laundering firm then transferred the money to the client, circumventing any judicial scrutiny.¹⁴⁹ In total, the \$11.3 million in known kickbacks were paid as follows:¹⁵⁰

Recipient of Kickback	Number of Lead-Plaintiff Cases	Total Received from Milberg Weiss
Seymour Lazar, Real estate owner	67 cases, 1976-2004	\$2,600,000
Howard Vogel, Real estate broker	40 cases, 1991-2005	\$2,500,000
Steven Cooperman, Ophthalmologist (CA)	70 cases, 1988-1999	\$6,200,000
Unnamed Plaintiffs (FL)	60 cases, 1983-1999	Unknown
Stockbrokers	Unknown number of referrals	Unknown

The final row for stockbrokers, as suggested in the testimony against Steven Schulman, contains no entries because none are listed in the indictment. But, if the allegations by Stockbroker A are true, then the \$11.3 million figure represents only a fraction of Milberg Weiss's total kickbacks.

The kickback story becomes murkier after the passage of the PSLRA in 1995 because, theoretically, the PSLRA's lead-plaintiff provision should have diminished the effect of filing a complaint first.

Government's Consolidated Opposition to Motions by Defendants Steven G. Schulman, Seymour Lazar, and Paul T. Selzer to Dismiss Indictment Due to Invalid Honest Services Fraud Theory; Exhibits Attached Separately ex. 3, at 30–31, *United States v. Milberg Weiss Bershad & Schulman LLP*, No. CR 05-587(A)-JFW (C.D. Cal. filed July 11, 2007) [hereinafter *Sworn Statement of Stockbroker A*], available at <http://fortunelegalpad.files.wordpress.com/2007/07/exhibitc-stockbrokera.pdf>.

146. See Second Superseding Indictment, *supra* note 10, at 10–11 (listing the intermediary firms Milberg Weiss used in Los Angeles, Portland, Oregon, Wichita, Denver, and throughout California).

147. *Id.* at 22–23.

148. *Id.* at 23.

149. *Id.* at 10–11.

150. All information in the chart is derived from Second Superseding Indictment, *supra* note 10, at 11–14; Sworn Statement of Stockbroker A, *supra* note 145, at 26–31; Elkind, *supra* note 10, at 163–170.

The indictment against Milberg Weiss, however, chronicles ongoing payments to clients through 2005, primarily to Howard Vogel and Seymour Lazar.¹⁵¹ Neither the first nor the second indictment lists William Lerach as having participated in the kickback scheme after the PSLRA. Lerach confirmed this in a correspondence:

[T]he evidence of my involvement was much less than with respect to certain others and there was no evidence of any active participation by me after the passage of the 95 Act which, for the first time, explicitly forbid payments to plaintiffs, thus raising serious statute of limitations issues

. . . The 95 Act prohibited extra payments to class plaintiffs or brokers and as to any cases filed after the effective date of the 95 Act I scrupulously adhered to its provision. It turns out that apparently certain people at Milberg Weiss did not comply—that was something I did not know about—but unfortunately, under criminal conspiracy law, is something I faced exposure for.¹⁵²

Yet, some individuals at Milberg Weiss perceived some utility from continuing to pay for named-plaintiff status, which accounts for the payments through 2005.

By 2002, the media reported that Milberg Weiss was under federal investigation for its payments to plaintiffs.¹⁵³ Although the firm and, notably, Lerach received positive attention for securing lead-plaintiff status in the class action suits against the banks and accounting firms involved in the Enron scandal,¹⁵⁴ more negative attention ensued as the federal investigation of the law firm continued

151. See Second Superseding Indictment, *supra* note 10, at 38–45 (chronicling Milberg Weiss's filing of at least fifteen new lawsuits following the PSLRA).

152. E-mail from William S. Lerach to author (Dec. 11, 2007, 14:02:19 EST) (on file with the *Duke Law Journal*) [hereinafter Lerach, Second E-mail].

153. For example, the *New York Times* reported,

A federal grand jury is investigating whether a leading class-action law firm based in New York paid plaintiffs to take part in investor suits against companies

The investigation focuses on Milberg Weiss Bershad Hynes & Lerach, a law firm that has filed hundreds of shareholder lawsuits against some of the nation's largest corporations and that was responsible for 85 percent of all securities class actions in California last year.

Milberg Weiss Faces Inquiry, Report Says, N.Y. TIMES, Jan. 26, 2002, at C3.

154. See Michael Brick, *Lawyer Known for Class Actions Will Lead the Enron Plaintiffs*, N.Y. TIMES, Feb. 16, 2002, at C1 (noting Lerach's role as lead attorney and his record of success).

to linger.¹⁵⁵ Further attention followed Lerach and Weiss's decision to split the firm in 2004.¹⁵⁶ By the time the grand jury issued indictments in 2006, much of the damage to Milberg Weiss had already been done by years of negative publicity.¹⁵⁷

In the summer of 2007, former Milberg Weiss managing partner David Bershad, who kept the safe of cash used to pay many of the kickbacks, became the first person named in the indictment to plead guilty, forfeiting approximately \$8 million and agreeing to serve between two and three years in federal prison.¹⁵⁸ On September 18, 2007, Lerach agreed to plead guilty to a felony charge,¹⁵⁹ forfeit \$7.75 million, and serve between one and two years in prison.¹⁶⁰ Under the arrangement, Lerach admitted that he caused his clients to "falsely certify to a federal court that he hadn't received any payments, beyond reasonable costs and expenses."¹⁶¹ According to Lerach, "I did this because I was guilty, and because under the plea arrangement, the prosecutors accepted my position that I not cooperate against others, that my new firm [Lerach Coughlin] and its partners not be subjected to further investigation or prosecution."¹⁶² Schulman pled guilty to a federal racketeering charge in October 2007.¹⁶³ Finally, Melvyn Weiss pled guilty to fraud in March 2008, agreeing to serve three years in prison and pay \$10 million in fines.¹⁶⁴

155. See John R. Wilke, *U.S. Pushes Broad Investigation into Milberg Weiss Law Firm*, WALL ST. J., June 27, 2005, at A1 (mentioning alleged "secret, illegal payments to plaintiffs" and potential "criminal charges against the firm itself and its principals").

156. Kara Scannell, *Milberg Weiss to Split in Two: West Coast, East Coast Firms*, WALL ST. J., June 12, 2003, at B2 (noting the firm's plan to split up).

157. As William Lerach related,

What did badly disadvantage Milberg Weiss in obtaining lead plaintiff appointments is the increasingly negative publicity surrounding the criminal investigation which was exploited by competitors to gain competitive advantage against Milberg Weiss, both in the search for clients and in lead plaintiff contacts. With the ultimate indictment of the firm and certain of its senior partners, these developments proved, in my opinion, fatal.

Lerach, Second E-mail, *supra* note 152.

158. Peter Elkind, *Milberg Weiss Hits the Canvas*, FORTUNE, Oct. 15, 2007, at 40, 40.

159. *Id.*

160. Nathan Koppel, *Investigation of Milberg Lands a Pivotal Figure; Lerach Agrees to Pleas, Could Go to Prison; Gains Forfeited to U.S.*, WALL ST. J., Sept. 19, 2007, at B4.

161. *Id.* (characterizing the allegations to which Lerach would admit).

162. Lerach, Second E-mail, *supra* note 152.

163. Michael Parrish, *Bail Is Set for Lawyer Who Sued for Investors*, N.Y. TIMES, Oct. 13, 2007, at C3.

164. Jonathan D. Glater, *High-Profile Trial Lawyer Agrees to Guilty Plea*, N.Y. TIMES, Mar. 21, 2008, at C1.

B. Milberg's Market Dominance

In isolation, the guilty pleas of a half-dozen attorneys should have been inconsequential to the plaintiffs' bar. But William Lerach and the attorneys at Milberg Weiss did not face the intense competition that typifies the defense bar. Rather, an analysis of Milberg Weiss's market share shows that the firm controlled the market for securities class actions. Surprisingly, this market domination only increased post-PSLRA, a testament to the ineffectiveness of Congress's so-called "bill of attainder" against Milberg Weiss and William Lerach. Although Congress expected the lead-plaintiff provision to encourage institutional investors to check the power of firms like Milberg Weiss, an analysis of Milberg Weiss's market share reveals that, in reality, this expectation was unfounded.

Statistical models of plaintiffs'-firm market shares show that the PSLRA did little to curb the influence of Milberg Weiss or lawyer-driven litigation. A study by PricewaterhouseCoopers found that in 2001, Milberg Weiss filed about 60 percent of all securities class actions in the United States and 80 percent of cases in California.¹⁶⁵ In those cases, 50 percent of Milberg Weiss's clients were institutional investors, up from 5 percent prior to the passage of the PSLRA.¹⁶⁶ Cornerstone Research's ongoing study of class action settlements also tracked the growing dominance of Milberg Weiss after the PSLRA and through 2006.¹⁶⁷ Between 1997 and 2004, Milberg Weiss served as lead counsel in 50 percent of settled securities class actions in the United States.¹⁶⁸ By 2006, Lerach Coughlin served as lead counsel in 31 percent of all settled cases, and Milberg Weiss handled 23 percent (54 percent combined),¹⁶⁹ showing that their share of the market still continued to increase after 2004.

The data on market share is corroborated by Professors Choi and Thompson, whose research on lead-counsel selection led them to conclude that many of the intended reforms of the PSLRA lacked the efficacy Congress predicted.¹⁷⁰ Their data showed neither a substantial

165. Drummond, *supra* note 17, at 24–25.

166. *Id.* at 25.

167. LAURA E. SIMMONS & ELLEN M. RYAN, CORNERSTONE RESEARCH, SERV. SECURITIES CLASS ACTION SETTLEMENTS 16 (2007), available at http://securities.stanford.edu/Settlements/REVIEW_1995-2006/Settlements_Through_12_2006.pdf.

168. *Id.*

169. *Id.*

170. Choi & Thompson, *supra* note 83, at 1514–15, 1529–30.

entry of new firms nor an exit of larger old firms from the securities bar.¹⁷¹ New firms that did enter the market rarely participated as lead counsel in a lawsuit.¹⁷² As other top plaintiffs' firms began to lose market share post-PSLRA, Milberg Weiss held relatively steady. For instance, Milberg Weiss's share of the securities market (as measured in settlement dollars obtained in class actions) remained at 27.9 percent pre-PSLRA and 27.4 percent post-PSLRA—a loss of only 0.5 percent.¹⁷³ The next four top securities firms combined controlled 28.3 percent pre-PSLRA and 24.8 percent afterwards, which is a loss of 3.5 percent.¹⁷⁴ Further, this data set did not include recent litigation data, such as the Enron settlement in which Lerach, serving as lead counsel, obtained approximately \$7 billion for defrauded investors.¹⁷⁵

C. *Moving Beyond Kickbacks*

In a hard lesson in unintended consequences, the law originally aimed at diminishing the influence of Lerach and Milberg Weiss seemed to foster their ascendance to almost monopolistic dominance of the plaintiffs' bar. By 2004, 50 percent of Milberg Weiss's clients were institutional investors, up from 5 percent pre-PSLRA. Although kickbacks could be paid to individual clients, the firm used other tactics to recruit institutions. This Section briefly examines these recruitment methods to account for the other factors that contributed to the firm's prowess. Some of these recruitment tactics, although not the focus of the Milberg Weiss scandal, evidence a class action system with more problems than just kickbacks.

First, the institutional investors (for example, public retirement funds) favored by the PSLRA have established repeat relationships with large plaintiffs' firms.¹⁷⁶ In the same way that lawyers could count on certain professional plaintiffs to file lawsuit after lawsuit, these institutional investors have found it profitable to lead class action

171. *Id.* at 1514 (“Looking beyond the largest five firms, we do not see substantial entry or exit after the enactment of the PSLRA. Of all plaintiff lead or co-lead law firms that appear in our survey post-PSLRA but did not appear pre-PSLRA, the average number of suits was only 1.51; only three firms in this group had at least four suits.”).

172. *Id.* (“[N]ew plaintiff law firm entrants in the post-PSLRA period represented only a small fraction of the total market share of firms.”).

173. *Id.* at 1515 tbl.3.

174. *Id.*

175. Jeff Bailey, *CIBC Pays to Settle Enron Case*, N.Y. TIMES, Aug. 3, 2005, at C1; *Judge Approves 3 Enron Banks' Civil Settlement*, N.Y. TIMES, May 25, 2006, at C2.

176. Choi & Thompson, *supra* note 83, at 1528–29.

after class action.¹⁷⁷ Evidence also suggests that these institutions rely heavily on the direction of plaintiffs' firms instead of developing expertise in house to guide decisionmaking.¹⁷⁸

Large plaintiffs' firms have also used political influence and maneuvering to secure lead-counsel selection. Some firms hired lobbyists¹⁷⁹ and gave campaign contributions to persuade elected officials responsible for selecting lead counsel to represent public retirement funds.¹⁸⁰ Indeed, Milberg Weiss was one of three law firms to disclose publicly that it hired such lobbyists.¹⁸¹

In addition to paying questionable campaign contributions to public pension managers and using lobbyists to persuade fund managers, a rumor suggests that Milberg Weiss paid a share of its attorneys' fees to labor pension funds it represented to secure business—a potential violation of labor laws that bar paying referral fees for union business.¹⁸² Milberg Weiss and other top firms can make these payments and recruit institutional investors because they have capital not generally present in plaintiffs' firms.¹⁸³ William Lerach believes that Milberg Weiss was able to successfully adapt to the changes of the PSLRA and traced much of that success to the firm's established position:

Anytime where you have a dominant law firm, obviously that dominant and preeminent law firm is disadvantaged by the very fact that the rules have been changed. Clearly the existing system worked well for them. However, Milberg Weiss, perhaps not perfectly, adapted relatively quickly to the new order. It relatively

177. *See id.* at 1528 (noting that the prevalence of institutional investors serving as lead plaintiffs has increased markedly since Congress enacted the PSLRA).

178. *See id.* at 1529, 1528–30 (“Institutional investors may lack the time, resources, or ability to distinguish among companies in deciding where to bring a fraud suit. Instead of developing such costly expertise in-house, institutional investors may turn to a select group of plaintiff law firms for ongoing information and advice.”).

179. Cox & Thomas, *supra* note 96, at 1611.

180. *Id.* at 1613.

181. *Id.* at 1614 n.111 (citing public records from Alaska and California).

182. E-mail from confidential source (Dec. 13, 2007). For an example of a similar allegation leveled toward Milberg Weiss, see Posting of Peter Lattman to Law Blog, <http://blogs.wsj.com/law/2006/06/22/milberg-weiss-watch-hello-springfield-ill-lawyer-william-cavanaugh/> (June 22, 2006, 16:15 EDT).

183. *See, e.g.*, Peter Charles Choharis, *A Comprehensive Market Strategy for Tort Reform*, 12 YALE J. ON REG. 435, 476 (1995) (claiming that “plaintiffs’ law firms would have to be huge” to invest adequate capital into many mass tort suits).

quickly came to represent a large number of institutional clients and continued to do very well economically for itself.¹⁸⁴

Lerach has acknowledged the shortcomings of laws that help firms like Milberg Weiss: “Of course, making the rules more difficult, [or] the capital requirements more onerous favors established firms, but does not mean it [was] good public policy.”¹⁸⁵

Regardless of the tactic, the evidence suggests that law firms continue to be chosen using suboptimal criteria such as personal relationships, as opposed to quality of representation.

III. A NEW SYSTEM: ADDING DISCLOSURES AND SCREENING TO LEAD-COUNSEL SELECTION

The final Part of this Note attempts to create a system of counsel selection in which “quality of representation” becomes the primary selection factor. This Part assumes, based on the preceding two Parts describing the state of lead-plaintiff selection, that the original goals of the lead-plaintiff provision of the PSLRA—to prevent plaintiffs’ attorneys from initiating and managing securities class actions¹⁸⁶ and to ensure settlements consistent with the merits of a case¹⁸⁷—remain unfulfilled.¹⁸⁸ By adopting a new approach to counsel selection based on information disclosure, this Part suggests reforms that would allow the original PSLRA goals to take steps toward fulfillment.

184. Telephone Interview with William S. Lerach (Dec. 13, 2007) (notes from interview on file with the *Duke Law Journal*).

185. Lerach, First E-mail, *supra* note 43.

186. Choi & Thompson, *supra* note 83, at 1490.

187. *Id.*

188. By suggesting reform in the wake of the Milberg Weiss scandal, this Note does not imply that the plaintiffs’ bar is corrupt; rather it assumes that plaintiffs’ law firms are honest but continue to operate in a system full of vulnerabilities that are easily exploitable and hardly detectable. The investigation against Milberg Weiss proceeded for nearly seven years without an indictment. See Elkind, *supra* note 10 (noting that Cooperman first began cooperating with prosecutors in 1999). In one of Peter Elkind’s many significant investigative pieces for *Fortune*, he recounts the story of Assistant U.S. Attorney Richard Robinson, who followed Cooperman’s original lead for years before a case began to emerge. *Id.* at 164. Even press reports in 2005 showed that securities lawyers remained unaware that Milberg Weiss had been engaged in this practice for twenty years or, possibly, naïve that what Milberg Weiss was doing was violating the law. See Justin Scheck, *Lerach Hunkers Down After Indictment*, RECORDER (S.F.), Aug. 16, 2005, <http://www.law.com/jsp/article.jsp?id=1124109328500> (“Yet despite the seriousness with which [Milberg and Lerach] are taking the investigation, many securities lawyers—most of whom are reluctant to speak publicly about it—remain puzzled by the investigation’s focus and skeptical that it will result in serious charges.”).

This Part is divided into three Sections. Section A identifies the problems of lead-counsel selection, drawing inferences from the Milberg Weiss scandal. Section B traces these problems to a broader underlying cause that academics and reformers have not previously identified—informational asymmetries between plaintiffs’ attorneys and judges. Using a system in which the law presumes that the most adequate plaintiff is the wealthiest one prevents the judge from considering pertinent information on plaintiff and attorney quality. Therefore, Section C concludes with a list of possible reforms that would limit or eliminate many of the information disparities judges currently face. Through disclosure requirements and screening procedures, these reforms could significantly reduce plaintiff attorneys’ opportunities to exploit informational asymmetries in the lead-counsel selection process.

A. Areas Needing Reform—Pre- and Post-Scandal

To draft meaningful reforms in selecting lead plaintiffs, it is necessary to summarize the problems that exist in the selection of lead counsel, despite the provisions of the PSLRA. Using the example of Milberg Weiss (both the legal and illegal aspects),¹⁸⁹ this Section compiles a list of the problems with the selection of lead counsel. The first two points present continuing problems that were also problems prior to the PSLRA; the second two points list problems that the downfall of Milberg Weiss revealed.

1. *Race to the Courthouse.* Despite the PSLRA, the entrepreneurial spirit of plaintiffs’ lawyers still leads a number of them to file lawsuits within hours of a precipitous stock drop.¹⁹⁰ Even though the PSLRA limited the first-to-file advantages, many attorneys still prefer to win the race to the courthouse because it allows them to post notice of the class action before their competitors, increasing the likelihood their firm will attract the client with the largest loss.¹⁹¹

189. See *supra* Parts II.B–C.

190. Perino, *supra* note 15, at 967 (“[The] pre-PSLRA strategic race to the courthouse has now been transmogrified into a race to publish the first notice. The net result, however, is the same—an incentive to file actions quickly.”); Weiss, *supra* note 101, at 561.

191. *Id.*

2. *Use of Professional Plaintiffs.* Although institutional investors have become more active plaintiffs, especially in high-profile cases like Enron, firms still use professional plaintiffs—establishing repeat relationships with individuals and institutions. For instance, Howard Vogel, the frequent Milberg Weiss client, filed two lawsuits and an affidavit in support of a proposed settlement between May 24, 2004, and September 23, 2004, with Milberg Weiss as his counsel.¹⁹² Even though this was permissible under the PSLRA provision limiting an individual to serving as lead plaintiff in five securities class action lawsuits in any three years,¹⁹³ it indicates that the continuing presence of professional individual plaintiffs is possible. Additionally, empirical evidence suggests that plaintiffs' firms and institutional investors are forming repeat relationships; Professors Choi and Thompson found evidence that some institutional investors were serving as repeat plaintiffs in multiple post-PSLRA class actions.¹⁹⁴ Perhaps more alarmingly, the institutions developed repeat relationships with the largest plaintiffs' firms, including Milberg Weiss.¹⁹⁵

3. *The Market for Awarding Lead-Plaintiff Status Is Imperfectly Competitive and Tends toward Oligopoly or Monopoly.* The analysis of market share between Milberg Weiss and the other top four firms in the securities plaintiffs' bar shows that Milberg Weiss controlled more than 50 percent of cases in a given year.¹⁹⁶ Professors Choi and Thompson found that the top-five plaintiffs' firms garnered three-fifths of all settlement awards in the late 1990s and early 2000s.¹⁹⁷ Further, they found little evidence of new participation by small firms in the class action market after the PSLRA,¹⁹⁸ whereas Milberg Weiss's and Lerach's market share continually increased.¹⁹⁹

4. *The Recruitment Process of Clients, Already a Substandard Method for Choosing Counsel, Is Mired in Secrecy.* Although the Milberg Weiss indictment involved individuals as opposed to institutional investors, the recruitment of individuals and institutions

192. Second Superseding Indictment, *supra* note 10, at 43–44.

193. 15 U.S.C. § 77z-1(a)(3)(B)(vi) (2006).

194. Choi & Thompson, *supra* note 83, at 1528.

195. *Id.* at 1528–29.

196. See *supra* text accompanying note 168.

197. Choi & Thompson, *supra* note 83, at 1515 tbl.3.

198. *Id.* at 1514.

199. See *supra* notes 165–69 and accompanying text.

is characterized by secretive dealings and ambiguous relationships. As this Note has observed, established plaintiffs' firms use a number of tactics, including paying questionable campaign contributions to public pension managers, hiring lobbyists to persuade fund managers, and using fees from labor organizations, to perpetuate their market control.²⁰⁰ This problem is especially pressing because private institutional investors, like hedge funds, have been less involved in securities class actions than public pension funds and unions,²⁰¹ with whom the dealings are more likely to occur.

* * *

When reformers tackled the race to the courthouse and professional plaintiffs in the early 1990s, their solutions were market based—using the PSLRA to substitute richer and presumably more sophisticated institutional clients for poorer ones to increase client monitoring of attorneys.²⁰² But, contrary to Professors Weiss and Beckerman's assumptions, the incentives of institutional investors, both public and private, are sufficiently complex²⁰³ that monitoring the behavior of class counsel will not always be a top priority. The presence of repeat relationships, combined with evidence that large institutions are not being aggressive in lowering attorneys' fees for the class²⁰⁴ and mixed findings on the ability of institutions to increase

200. See *supra* Part II.C.

201. Choi & Thompson, *supra* note 83, at 1504 ("There has been a substantial increase in participation of public pension firms, a group that includes well-known public employees' funds such as CalPERS, NYCERS, and funds related to various unions. At the same time, there has not been substantial involvement by private institutional investors, such as mutual funds, banks, and insurance companies. In the words of one federal appellate judge, 'the mutual funds won't touch it.'" (quoting Panel Discussion, *The Private Securities Law Reform Act: Is it Working?*, 71 FORDHAM L. REV. 2363, 2369 (2003) (statement of Edward R. Becker, C.J., U.S. Court of Appeals for the Third Circuit))).

202. See Weiss & Beckerman, *supra* note 13, at 2106 ("Institutions, as experienced and sophisticated consumers of legal services, are in little danger of succumbing to the kind of pressure or influence at which the ethical proscription of in-person solicitation is directed.").

203. See Choi & Thompson, *supra* note 83, at 1504–05 ("Serving as a lead investor and monitoring litigation costs money and takes the time of employees who otherwise could be engaged in alternative income-producing activities. Litigation may expose the institution to expensive discovery and unwanted revelation of information about its investments and strategy. It may also subject the fund to adverse responses from those with whom it does business (including, for example, if it manages funds in a 401(k) plan for other corporations).").

204. *Id.* at 1529 ("Institutions that depend on particular lead plaintiff law firms for information and expertise about litigation across repeat litigation are unlikely to negotiate vigorously with plaintiff law firms for lower fees.").

recoveries as a percentage of the loss,²⁰⁵ suggests that reliance on institutional investor responsibility is misplaced. The PSLRA's market-oriented solutions, which rely on the honesty of plaintiffs and their ability to monitor their attorneys, fail to understand or directly address the problem of unscrupulous attorney behavior. This behavior exists because information about clients and the merits of cases is held by attorneys instead of courts. It is this informational imbalance that reformers must correct.

B. The Presence of Asymmetrical Information

Client-based solutions to attorney abuse have been somewhat ineffectual. Recognizing that attorneys, not clients, instigated and perpetuated the Milberg Weiss scandal, this Note constructs a framework of lead-counsel selection that focuses on *attorneys* instead of clients. This framework assumes that the law can affect the behavior of plaintiffs' attorneys to maximize their honesty. The problems with dishonesty this Note has identified have a common source: asymmetrical information. Economists use "asymmetrical information" to refer to situations in which one party to a transaction or bargain has better information than the other party, preventing market participants from accurately judging the quality of goods or services in the market.²⁰⁶ Because attorneys face few requirements to disclose their recruiting methods or the substance of their client relationships to the courts, judges have difficulty adequately screening the merits of the putative class counsel. This Section explains why information imbalances create these problems.

During lead-plaintiff selection, the PSLRA mandates review of plaintiffs vying for appointment as lead plaintiff but not their lawyers.²⁰⁷ Under the PSLRA's lead-plaintiff provision, judges must consider which plaintiff has the "largest financial interest in the relief

205. Cox & Thomas, *supra* note 96, at 1636 ("Our real concern about institutions is that they do not seem to be able to increase dollar recoveries at the same pace as Provable Losses. This is disappointing and facially inconsistent with institutional lead plaintiffs' beliefs that they can double or triple recoveries overall.").

206. See DOUGLAS G. BAIRD, ROBERT H. GERTNER & RANDAL C. PICKER, *GAME THEORY AND THE LAW* 79–80 (1994) (defining asymmetric information); J. Hirshleifer, *Where Are We in the Theory of Information?*, 63 AM. ECON. REV. 31, 37 (1973) (same).

207. See 15 U.S.C. § 78u-4(a)(3) (2006) (requiring courts to review potential lead plaintiffs' financial interests, ability to represent the interests of the class, and susceptibility to unique defenses).

sought by the class.”²⁰⁸ Courts presume that the plaintiff with the largest financial interest is the most adequate, but the law does not *require* courts to scrutinize that plaintiff’s *choice of counsel*.²⁰⁹ Although courts ultimately have discretion to accept a plaintiff’s choice of counsel,²¹⁰ the PSLRA neither compels courts to review that choice nor instructs courts how to do so.²¹¹ Even more, despite the requirement in Rule 23²¹² of the Federal Rules of Civil Procedure that district courts evaluate the adequacy of class counsel, Rule 23(g) offers no substantive criteria to prevent the potential abuses particular to securities litigation.²¹³ Like the PSLRA, Rule 23 relies on a market-based approach that largely defers to a plaintiff’s choice of counsel, raising the same troubling implications about how much information is actually reaching judges.²¹⁴

In the modern system, judges are never *required* to consider whether an institutional investor selected class counsel because of the firm’s expertise in the subject matter, because the firm made campaign contributions to political figures, or because the firm paid kickbacks. Pre- and post-PSLRA lead plaintiff and counsel selection are remarkably similar—both systems relied primarily on a single presumption in selecting lead plaintiff; before the PSLRA, judges

208. *Id.* § 78u-4(a)(3)(B)(iii)(bb).

209. *See id.* § 78u-4(a)(3)(B)(v) (“The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.”).

210. *Id.*

211. *See* Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 BYU L. REV. 1239, 1288 (“[T]he statute is silent as to the criteria or method that the lead plaintiff should employ in selecting and retaining counsel. Nor does the law dictate that the lead plaintiff must monitor counsel’s efforts and participate in settlement decisions.”).

212. FED. R. CIV. P. 23(g)(1) (“Unless a statute provides otherwise, a court that certifies a class must appoint class counsel.”).

213. *Id.* Rule 23(g) states that a court must consider “the work counsel has done in identifying . . . potential claims,” “counsel’s experience in handling class actions,” “counsel’s knowledge of the applicable law,” and “the resources that counsel will commit to representing the class.” *Id.* 23(g)(1)(A). The court may consider “any other matter pertinent to counsel’s ability to fairly and adequately represent the interests of the class,” *Id.* 23(g)(1)(B), which, by its language, vests the court with the discretion to investigate or abstain, *id.*; *see also* Casey, *supra* note 211, at 1289–90 (detailing the many places in securities certification in which judges have discretion when dealing with class counsel).

214. *See* discussion *infra* notes 220–24 and accompanying text.

identified the first plaintiff to file suit;²¹⁵ post-PSLRA, judges focus on the client with the largest claimed losses.²¹⁶

The PSLRA also did not address the prior system's failure to give judges significant information about attorney quality. Judges need two types of information—verifiable and non-verifiable.²¹⁷ The PSLRA requires disclosure of neither type. Judges can check verifiable information (such as the number of the lawsuits the attorney has filed or settled) about a firm before making a decision. Nonverifiable information (such as an attorney's negotiation skills) involves inferences and a risk of error in decisionmaking, thus requiring judges to use signaling and screening to evaluate lawyers.²¹⁸

In terms of verifiable information asymmetries post-PSLRA, the Milberg Weiss scandal shows that many judges could not discern repeat professional plaintiffs from other claimants. The PSLRA requires plaintiffs to provide statements listing all federal securities class actions in which they have sought to serve as lead plaintiff in the preceding three years.²¹⁹ Although this information should be readily verifiable, the example of Howard Vogel's three filings in five months indicates that, to some extent, judges were (and are) not performing background searches (such a search would also have shown Vogel's 37 other lawsuits with Milberg Weiss).

Regarding nonverifiable information post-PSLRA, attorneys still do not present information about plaintiff-recruitment procedures to judges; for instance, attorneys generally do not reveal that they lobbied for institutional investors to hire them as counsel, and that information is difficult for courts to verify without extensive research costs. Further, courts struggle to obtain information about a firm's history of candor before courts when selecting lead plaintiffs. To

215. For a discussion of why "filing first" was the clearest signal available to judges, see *supra* note 77 and accompanying text.

216. See Casey, *supra* note 211, at 1289 ("[The PSLRA's] legislative history also advises that Congress intended to preserve 'the court's discretion under existing law to approve or disapprove the lead plaintiff's choice of counsel when necessary to protect the interests of the plaintiff class.'" (quoting H.R. REP. NO. 104-369, at 35 (1995))).

217. See BAIRD ET AL., *supra* note 206, at 89 (discussing the differences between "verifiable" and "nonverifiable" information).

218. Cf. *id.* at 123 (discussing how employers can use screening and employees can use signaling to exchange nonverifiable information).

219. 15 U.S.C. § 78u-4(a)(2)(A)(v) (2006).

eliminate uncertainty, plaintiffs' attorneys could signal²²⁰ to courts their quality by presenting private information about themselves or their abilities that the judge cannot otherwise observe.²²¹ Information about attorneys' honesty is absent in the PSLRA system. Instead, attorneys present judges with hollow biographical information about the plaintiffs' attorneys and boilerplate language about the quality of the law firm.²²² Judges can voluntarily screen large pools of attorneys by establishing procedures that sort high-quality from low-quality attorneys (such as auctions).²²³ The text of the PSLRA contains no such procedures, nor does it require judges to perform background searches on prospective lead plaintiffs or counsel.²²⁴

C. *Reforming the System*

Although this final Section does not attempt to draft an entire system for judges to use in selecting lead counsel, it does offer several reforms based on observed deficiencies that both the judiciary and Congress could implement without unreasonable burden or delays. To remedy current information asymmetries between lawyers and judges, mandatory disclosures made at various stages of litigation should be required. Next, nonverifiable information could be obtained if courts gave more time for law firms to signal their quality

220. See BAIRD ET AL., *supra* note 206, at 122–23 (discussing how signaling by parties possessing nonverifiable information and screening by uninformed parties can facilitate information exchange).

221. Cf. *id.* at 123 (“Industrious workers, for example, may be able to *signal* that they are hard workers by completing a training program that lazy workers would find too taxing.”).

222. For example, one motion for lead counsel appointment stated, “[t]he law firms have extensive experience in the area of securities litigation and have successfully prosecuted numerous securities fraud class actions on behalf of injured investors,” and then referred the judge to supporting affidavits. Memorandum in Support of the City of Saginaw Police & Fire Pension Board’s Motion for Consolidation of All Related Actions, Appointment as Lead Plaintiff, and Approval of Its Selection of Lead Counsel at 14, *Jacksonville Police & Fire Pension Fund v. Am. Int’l Group*, Nos. 08-CV-4772, 08-CV-5072, 08-CV-5464, 08-CV-5560, (S.D.N.Y. filed July 21, 2008), 2008 WL 4487375.

223. See *id.* (“Screening takes place when the uninformed players can choose actions that lead informed players to act in a way that reveals information.”). For example, a judge could decide to award fees only for a settlement in excess of \$500 million. In such a case, probably only high-quality attorneys would continue to seek lead counsel appointment; low-quality attorneys looking for quick settlements would withdraw. Because the primary screening process the PSLRA mandates is the consideration of which plaintiff had the largest losses, judges never encounter information about lawyers and their qualifications to represent a class.

224. See Casey, *supra* note 211 at 1288–89 (noting the similarity in pre- and post-PSLRA selection methods while pointing out that the legislative history indicates the act did intend to foster a private-auction process managed by institutional investors).

prior to counsel selection. By expanding the use of counsel-selection schemes (a screening process), which depend on attorneys revealing information about their ethics and past performances, judges could ferret out the best attorneys from quick-settlement artists.

1. *Verifiable Information and Disclosures.* First, courts must incorporate verifiable information during their selection of a lead plaintiff (who in turn selects lead counsel). Requiring sworn affidavits to the court subject to mandatory double checking and scrutiny could eliminate the use of both individual and institutional professional plaintiffs. This fix would begin with a more rigorous review of the plaintiffs, both institutions and individuals, by requiring those parties to disclose under penalty of perjury every case in which they have been involved during the past five years. This disclosure would expand the PSLRA requirement by two years, add significant penalties for dissembling, and, most importantly, add a mandatory review process by court officers or judges. These disclosures would include *both* state and federal cases, and verification would be required for any plaintiff strongly considered for the lead-plaintiff position. People or institutions that have recently served as lead plaintiffs should bear a presumption against appointment, regardless of whether they have not yet reached the PSLRA limit of five lawsuits. This presumption would replace or complement the current language that favors the appointment of the plaintiff with the largest financial interest.²²⁵ The development of a government-run computer database accessible to both state and federal judges, similar to the Stanford Securities Class Action Clearinghouse,²²⁶ would substantially assist the judge applying these new requirements in assessing a particular plaintiff's qualities. Judges could eliminate the Howard Vogels of the class-action system with a simple name search, and harsh penalties of perjury and contempt of court could bolster attorney acquiescence and honesty.

Following lead-plaintiff selection, a second round of scrutiny of law firms vying for lead-counsel appointment should occur. This scrutiny would eliminate secretive plaintiff recruitment and add competition to the highly concentrated market of lead-counsel firms. Given that class actions require attorneys to act in a fiduciary capacity

225. 15 U.S.C. § 78u-4(a)(3)(B)(iii) (2006).

226. Stanford Law Sch. & Cornerstone Research, Securities Class Action Clearinghouse, <http://securities.stanford.edu/> (last visited Nov. 16, 2008).

toward the class,²²⁷ rigorous scrutiny of a plaintiff's choice of competent and qualified counsel promotes the interests of all the claimants who have no voice in the selection of their legal representative. Given the absence of clear standards in the PSLRA and Federal Rule 23,²²⁸ scrutiny would mean enumerating several criteria that judges should apply when judging qualified counsel. These criteria should draw out information about attorney quality and experience with class action lawsuits.

A useful proxy that the new system could incorporate for quality of representation employed in Cornerstone Research's examination of law firm quality²²⁹ is the amount of fees recovered from a settlement or judgment as a percentage of the total losses suffered by the represented class. If attorneys knew that judges would use their performance in a case to judge their future fitness to serve as class counsel, they would state allegations and damages in complaints with greater specificity and accuracy. They would also avoid handling cases when they believed their representation likely could not garner a fee award that future courts, reviewing their performance, would deem satisfactory. The percentage of damages recovered could be measured and presented to courts in future litigations.

Whether the federal law also requires firms to disclose whether they lobbied institutional investors or made campaign contributions to officials responsible for hiring attorneys for public institutions, at a minimum, it must develop some system of disclosures. The system should have enough flexibility that lawyers can determine how they can best show courts their qualifications to serve as lead counsel, but the system must also be consistent. Although scholars, courts, lawyers, and legislators should debate which indicators of attorney quality courts should use, these groups should agree that, in the wake of the Milberg Weiss scandal, courts need to judge the quality of potential lead counsel with verifiable data.

2. *Nonverifiable Information and Screening.* With respect to *nonverifiable* information, judges can reduce information

227. *E.g., In re Gen. Motors Corp. Pick-up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 801 (3d Cir. 1995) ("Beyond their ethical obligations to their clients, class attorneys . . . also owe the entire class a fiduciary duty once the class complaint is filed.").

228. *See supra* notes 209–12 and accompanying text (noting the current absence of standards in the PSLRA and the Federal Rules).

229. SIMMONS & RYAN, *supra* note 167, at 16 tbl.16.

asymmetries by screening potential lead attorneys for quality.²³⁰ Reasonable examples of screening methods already in place should inspire judges to use screening in the future. For instance, in *In re Cendant Corp. Litigation*,²³¹ one federal judge implemented an auction to choose lead counsel.²³² Although it disapproved of the auction method,²³³ the Third Circuit recognized that such a screening procedure could be an appropriate method for lead-counsel selection in certain circumstances.²³⁴

In *Cendant*, the auction involved two stages—bidding and matching low bids.²³⁵ Competing firms submitted bids proposing what percentage of any settlement fee or recovery each firm would take.²³⁶ Once the court determined which firm presented the lowest acceptable bid for fees, the court gave the lead plaintiffs' law firm the opportunity to match that bid and assume lead-counsel position.²³⁷ The court exercised its discretion by rejecting and accepting bids as well as assessing the qualifications of the nine firms that competed in the auction.²³⁸ Allowing the firm selected by the plaintiff to voluntarily match the low-bid retains some of the autonomy of the PSLRA while still revealing firm quality. As Professor Baird notes, "[T]he willingness of a party to agree voluntarily to a term in a contract may signal the party's [quality]. Imposing a mandatory term may prevent

230. See *supra* note 223 and accompanying text.

231. *In re Cendant Corp. Litig.*, 264 F.3d 201 (3d Cir. 2001).

232. *Id.* at 218.

233. *Id.* at 220.

234. *Id.* ("Although we believe that there are situations under which the PSLRA would permit a court to employ the auction technique, this was not one of them."). The Third Circuit went on to state that the PSLRA "evidences a strong presumption in favor of approving a properly-selected lead plaintiff's decisions as to counsel selection and counsel retention." *Id.* at 276. A court could conduct an auction if the court was convinced that the plaintiffs did not select their counsel in good faith. *Id.*

235. *Id.* at 225.

236. *Id.* at 225 n.5 ("Movants were directed to propose fees depending on the phase at which the litigation was resolved (the horizontal axis) and the size of the eventual recovery (the vertical axis). The phases of litigation listed on the grid were: from pleadings through adjudication of any motion to dismiss; during discovery through adjudication of a summary judgment motion; after adjudication through a trial verdict; and post-trial. The sizes of recovery listed on the grid were: first 100 million; second 100 million; third 100 million; next 50 million; next 50 million; next 50 million; next 50 million; and over 500 million.").

237. *Id.* at 225.

238. *Id.* ("The District Court solicited input about how the auction should be conducted and held a hearing The District Court rejected [one] bid . . . which would have generated fees of 1–2% of the total settlement . . . characterizing it as unrealistic and 'quasi-philanthropic' (footnotes omitted)).

this signaling and thereby reduce the amount of information transferred.”²³⁹

The *Cendant* auction-matching method meets Professor Baird’s requirements because, after signaling, the firm that the lead plaintiffs wanted was given the *choice* to take the role of lead counsel—the court did not impose any truly mandatory terms. A firm had to be realistic but competitive because the attorneys’ fees depended both on the law firm’s bid and the firm’s ability to garner a high recovery. The firm had to realistically forecast how large of a recovery it could expect for a class, while also considering how much it would cost the firm to generate a high recovery. The auction forced firms to reveal two pieces of information: expectations and costs. With these two variables, courts now had more data to select lead counsel than otherwise available under the strict PSLRA lead-plaintiff analysis. With this information, the court eliminated certain firms based on unrealistic estimates the firms offered—the district court rejected a bid of 1 to 2 percent as “unrealistic and ‘quasi-philanthropic,’ and stat[ed] that ‘unless the eventual monetary recovery in this case is in the billions, such an apparently “cheap” fee does not make professional sense.’”²⁴⁰ Regardless of how a court structures the auction, the availability of multiple informational factors allows for better assessments of attorney quality and a positive step worthy of repetition.²⁴¹

Although courts do not need to copy the *Cendant* example or even use an auction, they can, without fear of reversal, allow a longer pretrial period for different firms to demonstrate their qualities. This lengthened pretrial period would allow judges to assist lead plaintiffs by suggesting factors plaintiffs should consider when picking counsel. Drawing from the bankruptcy code, judges could appoint temporary trustees to aid in the counsel-selection process.²⁴² These trustees could serve as temporary representatives of the class action until all plaintiffs and counsel are appointed and capable of fulfilling their fiduciary obligations. Courts could receive these trustees’ advice on

239. BAIRD ET AL., *supra* note 206, at 147.

240. *In re Cendant*, 264 F.3d at 225 (quoting the district court).

241. *See* Casey, *supra* note 211, at 1308–11 (providing a comprehensive discussion of auctions in securities class actions).

242. *See* 11 U.S.C. §§ 323, 327(a)–(e) (2006) (“Except as otherwise provided in this section, the trustee, with the court’s approval, may employ one or more attorneys . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee’s duties . . .”).

matters and attorney behavior and use it to ensure attorney integrity. Alternatively, judges could inquire why plaintiffs make their selections and receive affidavits detailing any prior relationships between plaintiffs and lead counsel.²⁴³ Under either option, however, allotting more time prior to court hearings for investigation of the plaintiffs in a case can only reduce the possibility of fraud.

CONCLUSION

The Milberg Weiss scandal should be a wake-up call to reformers who believed their modifications in the PSLRA would end securities class action abuse. Although William Lerach and Milberg Weiss are no longer going to dominate the field, the securities class action system remains vulnerable to exploitation and manipulation. Because “private securities class actions currently represent the principal means by which financial penalties are imposed in cases of securities fraud and manipulation,”²⁴⁴ the class action mechanism must remain free of the fraud and abuse to which the Milberg Weiss scandal showed it is susceptible. Encouraging or requiring freer dissemination of information by attorneys and lead plaintiffs to the courts would limit the possibilities of future abuse and monopolization, as in the Milberg Weiss scandal. More information disclosure should also mean greater competition among plaintiffs’ firms for lead-counsel status in class action suits. Although this Note has not addressed whether competition is necessarily a good thing for a class of defrauded investors, it is better than a monopolized market in which the pecuniary interests of a few large law firms seeking fast settlements drive results.

If Congress does not make these reforms, then it will have done nothing to prevent the emergence of the next Milberg Weiss. From questionable recruitment tactics of state pension funds to the lack of safeguards stopping professional plaintiffs, Congress can address many avenues of reform. With Milberg Weiss out of the picture, the opportunity for reform is ripe.

243. This Note does not address the potential transactional costs for judges who inquire into attorney qualifications during lead-counsel selection, which, as Section B notes, may be substantial. See discussion *supra* Part III.B.

244. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1536 (2006).